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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. 937.

THE COLUMBUS GAS AND FUEL COMPANY,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO AND THE CITY OF COLUMBUS, OHIO.

BRIEF ON BEHALF OF APPELLANT.

OPINION BELOW.

This is an appeal from the Supreme Court of Ohio, whose opinions are reported in 127 Ohio St., 109, and also appear at page 50, et seq., of the record. Final judgment was entered March 30, 1934. (R., 3244-3245.)

The opinions of the Public Utilities Commission are reported in P. U. R. 1933A, 337, and also appear at page 142, et seq., of the record.

JURISDICTION OF THE COURT.

Appellant has complied with paragraph 1 of Rule 12. Probable jurisdiction noted April 9, 1934.

STATEMENT.

When the court noted probable jurisdiction permission was given to use the briefs already filed in Case 608 and such other briefs as the parties may desire to present.

We shall here condense the arguments on the principal questions raised, asking that our opening and reply briefs in Case 608 be treated as appendices of this brief and referred to if needed for a more detailed treatment of the various questions.

On September 3, 1929, the city council of the city of Columbus, Ohio, passed an ordinance fixing the maximum price to be charged for natural gas at 48 cents per thousand cubic feet with a 75 cents per month minimum charge.

At the time of the passage of said ordinance the average rate for natural gas throughout Ohio was 63.8 cents per M c. f. (R., 688, 673), while the average rate throughout the United States was 62 cents per M c. f. (R., 687.)

Upon appeal to the Public Utilities Commission the price of 55 cents per M c. f., with a 75 cent minimum charge, was substituted for the ordinance rate. (R., 187.)

All but a small fraction of a cent of the difference between the 48 cent ordinance rate and the 55 cent substituted rate (reversed by the court) was due to the treatment of two items in the gate price:

(a) The allowance by the commission for the annual depletion of gas wells and leaseholds, 5.7129 cents.

(b) The allowance of West Virginia gas production expenses at the same rate as allowed by the West Virginia commission, 1.2284 cents.

Both appellant and the city prosecuted error to the Supreme Court of Ohio, where those cases were consolidated.

On March 30, 1934, the court below rendered final judgment as of June 21, 1933, (R., 3244-3245), and the cause was remanded to the Public Utilities Commission of Ohio forthwith to fix the 48 cent rate. (R., 3246.)

On April 2, 1934, the Public Utilities Commission ratified and confirmed said ordinance with its 48 cent rate and a 75 cents minimum. (R., 3252.)

On April 6, 1934, we caused this new appeal to be docketed based upon the Ohio Supreme Court's judgment entry of March 30, 1934.

United States v. Gomez, 68 U. S., 690;
Providence Rubber Co. v. Goodyear, 73 U. S. (6 Wall.), 153;
Borer v. Chapman, 119 U. S., 587;
Charles v. Fawley, 71 Ohio St., 50;
Perfection Stove Co. v. Scherer, 120 Ohio St., 445;
3 Corpus Juris, pp. 1058, 1059.

Appellant is an Ohio corporation engaged as a public utility in the distribution of natural gas in the city of Columbus, Ohio, and immediately surrounding territory. Since 1914 it has had no natural gas supply of its own but has purchased its supply under contracts from The Ohio Fuel Supply Company and its successor The Ohio

Fuel Gas Company, an Ohio corporation engaged in the production and transmission of natural gas at both wholesale and retail. (Co. Ex. 11, R., 2879; Co. Ex. 12, R., 2884.)

The voting stocks of The Ohio Fuel Gas Company, United Fuel Gas Company, (which produces and transports natural gas in the state of West Virginia), and appellant are owned by Columbia Gas & Electric Corporation.

Appellant buys no gas from United Fuel Gas Company. The Ohio Fuel Gas Company does buy a part of its supply (29% in 1929) from United Fuel Gas Company at the West Virginia-Ohio state line.

Neither the sale by The Ohio Fuel Gas Company to appellant nor the sale by United Fuel Gas Company to The Ohio Fuel Gas Company was subject to regulation as neither of these transactions constituted a sale to a **consumer** under Ohio statutes. (General Code 614-2; City's Brief, p. 284.)

St. Clairsville v. P. U. C. O., 102 Ohio St., 574;
Commission's Opinion, R., 147;
West Ohio Gas Co. v. P. U. C. O., 42 Fed. (2d), 899.

The principal questions in the case arise out of the fact that appellant has not been allowed in the rate fixed a sufficient amount to pay The Ohio Fuel Gas Company either the contract price, a fair market price or a reasonable price for the gas purchased at the city gates.

As appellant will be compelled to pay either the contract price, a fair market price or a reasonable price for the gas which it purchases at the city gates, the 48 cent rate now fixed by law will not only permit no return to appellant on any value of its property used and useful in furnishing the service, but will result in an operating deficit to appellant thus depriving appellant of its property without due process of law and denying to appellant the equal protection of the law, contrary to the Fourteenth Amendment, and/or impairing the obligation of the contract contrary to Section 10 of Article I of the Constitution of the United States.

Appellant therefore claims that said law fixing the rate for natural gas at 48 cents per M c. f., with a 75 cent minimum, is repugnant to the Constitution of the United States.

(Computations to show the above claimed operating deficit will be found at p. 232, et seq., of our opening brief in Case 608.)

SPECIFICATION OF ASSIGNED ERRORS INTENDED TO BE URGED.

These are set out at pages 20 to 26 of our opening brief in Case 608.

ARGUMENT.

Our assigned errors fall into three main classes:

I. Those pertaining to the valuation of appellant's property. The only property owned by appellant is its distribution plant.

II. The allowance in the rate for appellant's expenses.

III. The allowance in the rate of a reasonable return.

The expense allowance questions fall into two main classes:

(1) The cost of gas purchased from The Ohio Fuel Gas Company.

(2) All other expenses of appellant.

The questions (other than arising out of the contract Co. Ex. 11) pertaining to the cost of purchased gas are also divided into three groups:

(1) The valuation of the property of The Ohio Fuel Gas Company used and useful in producing and transporting natural gas to the Columbus gates.

(2) The allowance in the gate price for expenses of The Ohio Fuel Gas Company in producing and transporting natural gas to the Columbus gates.

(3) The allowance in the gate price of a fair return to The Ohio Fuel Gas Company on the value of its property used and useful in producing and delivering gas at the Columbus gates.

As to the valuation of the production and transmission systems of The Ohio Fuel Gas Company the most important questions are:

(1) The use of book values of leaseholds as a basis of valuation in the face of overwhelming expert testimony establishing higher values.

(2) Failure to allow any value for reserve gas leaseholds.

(3) Ascertaining the present value of gas wells—Account 211, Gas Well Construction, and Account 212, Gas Well Equipment—by deducting from the cost of reproduction new a percentage equal to the estimated depletion of the underlying gas. The cost of reproduction new was ascertained without regard to the original gas content and it was error to use the estimated remaining gas content in arriving at present value.

As to the expenses of The Ohio Fuel Gas Company in producing and transporting natural gas to the Columbus gateways, the most important questions arise out of the failure of the commission and court below to make any allowance in the gate price for the following expenses reasonably and necessarily incurred, to wit:

(1) Depletion of natural gas fields, wells and/or equipment.

(2) Amortization of facilities used in producing and transporting natural gas.

(3) Delay rentals actually paid on gas leaseholds.

In addition to failing to allow anything for the foregoing:

(4) There were insufficient allowances for both taxes and depreciation. While the city conceded annual depreciation of $2,848,301.74 (R., 160), the commission al-

lowed and the court below approved only $1,765,607.00. (R., 217.)

(5) A portion of the gas used in Ohio is purchased by The Ohio Fuel Gas Company at the state line from United Fuel Gas Company, which is subject to the jurisdiction of the Public Service Commission of West Virginia. In arriving at the operating expenses of The Ohio Fuel Gas Company the commission and court below disregarded entirely the contract between the companies (Co. Ex. 58, R., 2915) and held that the property of such West Virginia company should be valued, its expenses found, and allocation made in accordance with Ohio law, notwithstanding that the applicable Ohio law as interpreted by the court below conflicts with the applicable West Virginia law as interpreted by the highest court of that state where the property is located, resulting in a less than fair market price as established by similar sales to unrelated companies, e. g., Co. Ex. 59, (R., 2920), being a contract between United Fuel Gas Company and Hope Natural Gas Company.

(6) The testing of the sufficiency of the gate price by a demand-mileage allocation of the transmission property and expenses, which the evidence shows and the commission unanimously found to be **impossible** of application to the property valuation and operating expenses of The Ohio Fuel Gas Company.

We do not mean to here abandon any of our assigned errors. Our purpose here is to present to the court briefly our more important questions, relying upon our briefs in Case No. 608 for our argument in respect of the other errors assigned as well as for a more detailed presentation of the questions herein considered.

VALUATION OF APPELLANT'S PROPERTY.

Questions touching the valuation of appellant's distribution system are discussed at pages 205 to 207 of our opening brief and at pages 81 to 98 of our reply brief in Case No. 608, except going concern value, which is discussed along with the going concern value of The Ohio Fuel Gas Company at pages 123 to 131 of our opening brief and pages 65 to 69 of our reply brief in Case No. 608.

APPELLANT'S OTHER OPERATING EXPENSES.

Questions touching appellant's operating expenses other than gate price are discussed at pages 208 to 224 of our opening brief and at pages 99 to 102 of our reply brief in Case No. 608.

Annual Depreciation Allowance.

As shown in City Exhibit 69, page 1, (R., 3042), the city conceded an annual depreciation allowance of $88,695.03 on appellant's property. In the city's brief before the commission the city conceded an annual depreciation allowance on appellant's property of $97,533.50. (R., 160.) The commission allowed and the court approved only $68,196.00. (R., 220.) In order to avoid the effect of the testimony of their own witnesses and their own concessions in their brief before the commission

on the matter of depreciation, the city in its brief in Case No. 608 now says that they had not taken into consideration the existing reserves on the books of appellant. At page 87 of their brief counsel for city point out that appellant had a reserve for depreciation at the end of 1929 of $1,166,762.30 and at the end of 1930 of $1,251,886.77.

In the case of **The Columbus Gas and Fuel Company v. The City of Columbus**, 17 Fed. (2d), 630, the District Court held that the mains of the company, originally used for artificial gas, were no longer used and useful and should not be included in the rate base. That case is still pending. When it is finally decided, if the company is required to write off those artificial mains, its depreciation reserve will be wiped out completely. The outstanding bonds on those artificial mains referred to by the court in that case still amount to $1,296,000.00. (R., 2896.)

While the District Court found the value of appellant's plant as of August 31, 1925, to be $3,976,359.00 (R., 3006A), and while appellant has since added to its plant net additions at cost, with overheads at the rate allowed by said court, to represent a total present value of $5,354,317.27 (R., 3006A), the commission and court below allowed a value for appellant's plant of only $4,027,647.00. (R., 182, 220.) This shrinkage is sufficient by itself to wipe out appellant's depreciation reserve.

ACTUAL OPERATION UNDER THE 48¢ RATE.

Before proceeding to the gate price questions we desire to call the court's attention

(1) To the results of three years' actual operations under a 48 cent rate with a 75 cent minimum; and

(2) To what we believe to be irrelevant matters which the city attempts to introduce in its brief in Case 608.

Since 1924 appellant has neither earned nor paid a dividend. (R., 679.)

Appellant's average annual net income for the 5¾ years immediately preceding December 31, 1929 (the date certain in this case) amounted to 2.92% on its outstanding capital stock. (R., 678, 2986.)

As shown at R., 680 and 2897, appellant sustained a deficit from operations for the three years 1927, 1928 and 1929 which cover the period of Columbia ownership of appellant's capital stock.

In its brief in Case 608 the city intimates that this condition is due to exorbitant expenses. That the city is wrong in this charge we believe we have demonstrated in our reply brief (Case 608) at pp. 14 to 24, where we present the figures disclosed by the record.

An examination of the figures there presented will show that even if the gas purchased contract (R., 2879), which was entered into July 1, 1929, when it was thought that all litigation and differences between the city and appellant over the gas rate were settled by the enact-

ment of the so-called "65-cent ordinance"—No. 410-29 (R., 2983), were disregarded and all purchased gas be computed under the 1914 supply contract (R., 2884) at 31.2 cents per M c. f. and all management fees be reduced to cost as found by the commission in this case, appellant would have earned an annual return of but 3.64% on the value of its property used and useful as fixed by the commission in this case and much less than half of that rate on its outstanding capital stock. And it must be remembered that appellant was getting 16.8 cents per M c. f. for distribution during the years 1927, 1928 and 1929 against only 16 cents allowed in the instant case.

At page 22 of our reply brief in Case 608 we show that, while appellant's distribution plant has been increased more than one-third since the 1925 valuation made in the federal court case (R., 3006A; 17 Fed. (2d), 630), and while the estimated revenue from sales was greater in the federal court case than in the instant case, appellant has been here allowed only 16 cents per M c. f. as the cost of distribution against 16.8 cents allowed in the federal court case for a much smaller plant, with larger sales.

MARKET VALUE VERSUS BOOK COST OF LEASEHOLDS.

(Pages 93 to 118, Opening Brief; Pages 54-55, Reply Brief, Case 608.)

Majority Court Opinion, R., 62.

Dissenting Court Opinion, R., 73.

Majority Commission Opinion, R., 152.

Minority Commissioner's Opinion, R., 195.

In valuing the No. 1 operated leaseholds the commission disregarded market value (R., 153) and fixed an arbitrary value of $25.00 per acre, which is lower than any valuation in the record outside of the attempted cost of reproduction valuation by the city's engineer Blundon. (R., 196.) The commission claims to have considered delay rentals.

The court below at Record, 62, states that the commission fixed the $25.00 per acre because of the valuation found in the Logan Gas Company case.

While we think the commission was in error in fixing the $25.00, we cannot find in either the majority commission's or minority commissioner's opinion any basis for the foregoing conclusion of the court.

The court and minority commissioner refer to an "arbitrary write up" on the Logan Gas Company's leaseholds made during 1919. As shown by City Exhibit 85 (not certified to this court. However, it is a public commission record), The Ohio Fuel Gas Company purchased

the assets, including leaseholds, of The Logan Gas Company at a price authorized by the Public Utilities Commission of Ohio in its order of May 19, 1929—which would have been a very appropriate time for the commission to have taken up any "arbitrary write up" of 1919.

Our position on the use of book cost of No. 1 leaseholds is tersely stated in the language of Judge Jones' dissenting opinion below (R., 73):

> "The decision, by considering book values as a basis of valuation, in face of overwhelming expert testimony establishing higher values, is, in that respect, erroneous."

The commission said (R., 153):

> "Witnesses have been produced by the company who have testified that productive acreage is worth in the market all the way from $39.34 to $100.00 per acre. And they have also testified that there have recently been within reasonably close territory actual sales of acreage at a definite valuation."

In the majority per curiam below it is said (R., 62):

> "This court has held in a previous valuation case that the method of using cost to determine value of leaseholds did not give due regard to the value of the property used and useful."

Yet in face of this statement by the court below it ordered cost to be used as the measure of the value of the No. 1 leaseholds, for at Record, 63, the court below said:

> "In view of this holding of the United States District Court, and the specific holding of this court

in Logan Gas Co. v. Public Utilities Commission, 124 Ohio St., 248, we hold that the value of Class No. 1 leases should be reduced to book value, and reduced to the book value of Class No. 1 leases alone."

The only "value" on the books of The Ohio Fuel Gas Company for its leaseholds is the first cost to the utility of acquiring the leaseholds. (R., 1046.)

While the case of **United Fuel Gas Co. v. Railroad Commission,** 278 U. S., 300, is cited and discussed in the majority opinion below, there is nothing in that case which justifies the holding of the court below in respect of leasehold valuation. In that case this court, by Mr. Justice Stone, said (p. 314):

> "It was stated on the argument that these leases, not only singly but in blocks, are sold in open market, but their market price appears not to have been established."

A little later in the opinion Mr. Justice Stone said (p. 316):

> "Examination of their testimony discloses that these estimates were not based on prevailing prices for gas leases or on actual sales but, * * *."

In the **majority opinion below** it is said (R., 62):

> "No valuation can be based upon market price because of the fact that there is no market for a gas property so extensive as that of The Ohio Fuel Gas Company."

This statement is contrary to the undisputed evidence in the case. In the first place, there are only 291,396 acres of No. 1 leaseholds. The evidence shows that there is a market for a very much larger acreage of gas leaseholds.

At Record, 1284, the witness Webber testified on cross examination:

> "* * * investors in 1929 were looking for these big ones. I would have been delighted to have had that as a thirty-eight million dollar proposition. They wanted to look at things of five million or better. I have inquiries now for territories of good size, getting them ready for later offers."

At Record, 1129, the witness Dally was asked and answered:

> "Q. They have been asking questions here that indicated that they didn't think there was any market for natural gas properties. Is there a market for natural gas property such as this? A. There is."

And on the same page the witness Dally was asked and answered in respect of the entire holdings of The Ohio Fuel Gas Company (R., 1129):

> "Q. Well, can you get an offer within twenty-four hours for it? A. I believe I could."

The witness Dally also testified at R., 1142:

> "Q. You were asked concerning the so-called Cash-dollar sale; when did that take place? A. The latter part of 1928.
>
> Q. And how much acreage was involved in that? A. The total acreage involved at the time of pur-

chase was something above 102,000 or 103,000 acres —thereabouts."

At R., 1130, Mr. Dally testified that the average price for the Cashdollar leaseholds was between $75.00 and $80.00 an acre.

At R., 1197, the witness Wittmer was asked and answered on cross examination:

> "Q. Necessarily, Mr. Wittmer, where you have such a large acreage the number of possible buyers so-called is reduced, is it not? A. Yes, but it is all the more attractive."

At R., 1189, Mr. Wittmer was asked:

> "Q. Now, you have been asked about sales in Ohio. I wish you would tell the commission any sales that you know that were made in 1929 in the state of Ohio. A. In 1929 we sold to the Penn-Ohio Gas Company about 101,600 acres for $1,200,000 and included wells and leases located in Jackson, Lawrence, Carroll, Stark, Guernsey, Monroe, Morgan, Summit, Licking, Noble and Gallia counties. This property included 4000 acres of No. 1 classification; about 4600 acres of No. 2; 93,000 acres of No. 3. The prices that we used at that time—."

Amid the objections Mr. Wittmer stated that the price for the No. 1 was $150.00 an acre; for No. 2, $20.00 an acre; for No. 3, $3.00 an acre. The $150.00 an acre for No. 1 was in addition to the price of the wells. (R., 1193.)

At R., 1189, he testified:

> "Q. Now did you buy any acreage in the state of Ohio during the year 1929? A. We bought 7000 acres in Muskingum county for $100,000."

Market Value.

At Record, 1190, Mr. Wittmer stated that of the 7000 acres, with the exception of 50 acres it was practically undeveloped.

The witness Meals testified on cross examination (R., 1252):

> "The Witness: Yes, I know of a sale that was made since 1929, quite a large sale right in your territory in Summit and Stark counties."
>
> (R., 1253): "The Witness: In the immediate past, yes; but the property I refer to is the property in Summit and Stark counties that Sam Brendle sold to the (East) Ohio Gas Company.
>
> Q. How recently? A. Six or seven months ago.
>
> Q. Do you know what he got for the operated acreage?"

After objection and argument the witness answered (R., 1253):

> "A. He got in the neighborhood of two and one-half million dollars, in addition to the cost of his operation.
>
> Q. For how many acres? A. Something like 21,000.
>
> Q. How many were what we classed here as No. 1? A. The majority of that acreage would come under Class 2."

Appellant offered Company Exhibit 140 (R., 2989), which was a written offer from the Benedum-Trees Oil Company of thirty million dollars cash for the gas leaseholds of The Ohio Fuel Gas Company. This was not admitted by the commission and was ignored by the court below.

The evidence showed (R., 1132, 1195, 1307) that the Benedum-Trees Oil Company was responsible.

Market Value.

In our opening brief in Case 608 at pages 97, et seq., we have set out some of the testimony of the valuation witnesses. The substance of this evidence is:

(a) There is a market for all of the leaseholds of the company.

(b) Sales are shown.

(c) The prices placed on the leaseholds are what a willing buyer would pay a willing seller and are not dependent upon the regulated price of gas.

(d) The appraisers had all the data that a prospective purchaser would want.

(e) The leases of the company are interspersed with the leases of other companies and individuals.

(f) The leaseholds can be sold at the prices set forth for the purpose of furnishing gas as a competitive fuel.

(g) There is a market outside of Ohio for the gas obtained from these leaseholds.

(h) The valuation was made in accordance with the practices of the industry.

We think the following illustration which we have adopted from the brief of The East Ohio Gas Company in a proceeding now pending before the Public Utilities Commission of Ohio **demonstrates** the error of the Ohio Supreme Court on leasehold valuation:

"This remarkable decision, which we will refer to hereafter as the **'Columbus case,'** is wholly without precedent and is indefensible on any ground. Perhaps this can be best illustrated by showing its effect.

Market Value.

Let us assume that during 1925 the X gas company leased 35,000 wildcat acres at the usual cost of $1 per acre. This $35,000, in accordance with the usual practice, is charged to capital through Account 205. It carried the acres as undeveloped for 3½ years, paying annually $1 an acre as delay rental which it charged to operating expenses as required by the commission's classification of accounts. Thus the total cost of delay rentals was $122,500 and the total cost of carrying and acquiring to that date was $157,500, without considering, for purposes of simplification, interest on these payments.

Assume further that in 1928 the X company drilled ten producing wells at a cost of $15,000 each or a total of $150,000. It also drilled a number of dry holes which need not be considered here because dry hole costs will be allowed to it out of operating expenses. As a result of this drilling and the drilling of dry holes or light wells by others the company in 1928 surrendered and cancelled 28,000 acres and transferred to operated acres 2000 acres, continuing to carry the balance of 5000 acres as reserve unoperated. The ratio of the acreage so cancelled to the productive leases developed therefrom is actually much less than has been the combined experience of East Ohio and Hope. (E. O. X. 30, p. 8; E. O. X 31, p. 7.) The three and one-half years this unoperated acreage was held before it was cancelled corresponds with East Ohio's experience. (E. O. X 30, p. 9.)

In 1933 the X company has a rate case in Ohio. At this time the productive wells drilled in 1928 have de-

clined from an initial rock pressure of 1000 pounds to 500 pounds.

Under the **Columbus** case these leases and wells would go into the rate base substantially as follows:

Book cost of 2000 operated acres	$2,000
10 productive wells—reproduction cost new less depreciation on rock pressure decline basis	75,000
5000 unoperated acres	nothing
28,000 surrendered acres	nothing
Total for rate base	$77,000

Actually up to 1928 without any allowance for interest the company has spent the following amounts:

Original cost of acquisition of acres now operated	$2,000
Original cost of acquisition of 5000 unoperated acres	5,000
Original cost of acquisition of 28,000 surrendered acres	28,000
Delay rentals	122,500
10 productive wells	150,000
Total without interest	$307,500

Even if the whole of this direct out-of-pocket cost were depreciated on a rock pressure decline basis, which it should not be, there would still remain in 1933 at least fifty per cent. of this cost of $307,500, or $153,750. And this figure would in nowise reflect the additional $25,000 spent for delay rentals on the 5000 unoperated acres car-

ried from 1928 to 1933 to insure the sufficiency of the company's productive capacity.

It will be observed that we do not need to know whether these 10 productive wells had 10 thousand cubic feet or 5 million cubic feet initial open flow since in either case they go into the rate base at precisely the same figure. And we do not need to know the rock pressures for the purpose of determining anything in connection with the rate base except the accrued depreciation.

When in the assumed 1933 rate case we come to an allowance to the X company for annual operating expenses in connection with leaseholds and wells under the **Columbus** case there would be included substantially the following:

Depreciation on book costs of 2000 operated acres, assume 10% annually	$200
Depreciation on 10 wells, assume 10% annually	15,000
Annual delay rentals on 5000 unoperated acres	nothing
Allowance for surrendered acreage	nothing
Return on rate base, 6½% of $77,000	5,005
Total annual allowance	$20,205

Of this $20,205 the company will have to pay out $5000 for lease rentals on unoperated acres, leaving $15,205 for all other purposes. At the end of the 5-year remaining life of these operated leases it will thus get back $76,025 of its out-of-pocket development costs, which as of 1933 cannot be computed on any basis to be less than $153,750, **without any return thereon in the meantime.** And if it

spends, as a going company must, additional money in turning over acreage in further development the $76,025 will be even less by these additional amounts.

In other words, under the **Columbus** case a company can never recover even its out-of-pocket development costs where it explores for and discovers natural gas. This decision places upon the company the whole risk of using its stockholders' money for the acquisition, carrying, testing and development of operated acres. If these prove non-productive the stockholders have lost all but the dry hole money spent in their development. If they prove productive then the company is allowed in its rate base merely the nominal cost of acquisition of those acres only under which gas was later proved by drilling and the reproduction cost new of the productive wells, depreciated, however, on a rock pressure decline basis. And on this wholly inadequate rate basis it is allowed a rate of return such as one expects on well secured first liens."

Under the lowest value testified to by any witness for No. 1 leaseholds ($39.37 per acre), at a 6½ per cent. return the retail rate would be increased .5336 cents per M c. f. (See p. 271, Opening Brief, Case No. 608.) In other words, if The Ohio Fuel Gas Company can base its gate price on the market value of its No. 1 leaseholds, then it can recover from appellant at least approximately $30,264 per year more for gas than appellant has been allowed therefor in the 48 cent rate.

RESERVE LEASEHOLDS—VALUATION AND DELAY RENTALS.

(Pages 64 to 84, 118 to 123, Opening Brief, and 56 to 62, Reply Brief, Case No. 608.)

Majority Court Opinion, R., 62.

Dissenting Court Opinion, R., 74.

Majority Commission Opinion, R., 154.

Minority Commissioner's Opinion, R., 196.

Neither the commission nor the court below made any allowance in the gate price for a return on the value of any reserve leaseholds owned by The Ohio Fuel Gas Company.

Both the commission and court below disallowed the annual expense incurred by The Ohio Fuel Gas Company under Account No. 360 of $1,684,913.00 for lease rentals actually paid on reserve leaseholds.

The commission fixed the reproduction cost new of The Ohio Fuel Gas Company's production and transmission properties at $90,913,953.00 and the present value at $64,563,248.00, exclusive of leaseholds, working capital and materials and supplies. (R., 180.) Without a supply of natural gas this property is merely scrap and probably not worth the expense of salvaging.

To support this investment the commission and court below have allowed only 291,396 acres of operated leaseholds, which the commission found to be sufficient for only three years and two months. (R., 161, 74.)

Gas Reserves.

The court below has directed that book cost only should be allowed for the No. 1 leaseholds only. (R., 63.)

The company also carries a reserve of 164,739 acres of No. 2 leases of tracts of land proved by actual development and operations in the immediate vicinity thereof to be good gas producing lands but which do not have any producing wells drilled thereon. (R., 3124.)

At record 1048 and 3002 it was shown that in 12 different counties of the state, ranging from Gallia at the Ohio river to Ashland in the north, it was necessary for the company to make annual payments in lieu of drilling because of complaints by lessors that the gas under the undrilled acreage was being taken out through the wells on No. 1 leaseholds.

The lowest valuation placed on the No. 2 leaseholds is $60.00 an acre, or a total value of $9,884,340.00. (R., 2910.)

The company also carries a reserve of 312,631 acres of No. 3 leases of tracts of land shown by surrounding or neighboring developments or operations, geological considerations, etc., to be reasonably certain to be good gas lands. (R., 3124.) The lowest value placed on the No. 3 leaseholds is $4.00 per acre, or a total of $1,250,524.00. (R., 2910.)

In addition to the foregoing the company carries 2,065,421 acres of No. 4 leaseholds of tracts of land situated within the areas of territory where gas sands are known or assumed to exist from general geological conditions but which are considered merely prospective gas lands.

(R., 3124.) The lowest valuation placed on the No. 4 was $2.00 per acre, or a total of $4,130,840. (R., 2910.)

Delay rentals are paid on all classes except No. 1 operated. As soon as a productive well is drilled upon a lease delay rentals cease and well royalty payments begin. (R., 1013.)

Between June 30, 1929, (the date certain of the leasehold valuation) and May 31, 1931 (the time of the hearing), 685 wells had been drilled by the company in 28 counties of the state, of which only 98, or 14.3%, were drilled in No. 1 territory; 287, or 49.9%, in No. 2; 130, or 19%, in No. 3; and 170, or 24.8%, in No. 4. Of the 170 wells drilled in the No. 4 territory in 28 different counties, 90 wells located in 19 different counties were productive. (R., 3002, 1319, 1320, 1052.)

As drilling operations progress new leases are taken and the old leases surrendered.

In the city's brief in Case 608, at p. 135, it is said:

> "* * * in 1930 Ohio Fuel abandoned 525,445 acres of this unoperated leased territory."

This statement as made is misleading. In City Exhibit 49 it is shown that in Account 360 "Rental Unoperated Leases" the lease rentals in 1930 amounted to $1,888,572.22, being an increase of approximately $350,000 over 1929, and showing a net increase in unoperated acreage.

We have discussed this matter further at page 60 of our reply brief in Case 608. What we desire to call attention to here is that as pools are outlined by drilling

operations leases which do not indicate gas are surrendered. As new pools are indicated by further drilling operations protective leases and leases in the probable direction of the pool are taken and held pending the development of that pool. The actual operation is a constant sifting of the leaseholds. As has been shown by the testimony, only one acre out of ten of prospective gas lands becomes producing gas territory. (R., 1380.)

Company Exhibit 179 (R., 3001) shows that during the years 1927, 1928 and 1929, 46,333 acres were transferred from unoperated to operated acreage. Applying the average of one out of ten, this means that 463,330 acres were culled.

The No. 2 and No. 3 combined amount to only 477,370 acres. That, on account of the spread of the territory, operating conditions and development, some No. 4 must be continually drilled, is obvious.

No more drilling can be done economically on the No. 1 leaseholds. (R., 1053.)

If The Ohio Fuel Gas Company were confined to its No. 1 leaseholds during the five year period of the ordinance in question, additional compressor stations would be needed and additional off-set wells would have to be drilled. (R., 1052 to 1054. See testimony quoted at pages 57 and 58 of our Reply Brief in Case 608.)

If a gas producing company fails to protect its productive territory the gas under its leases is sure to be drawn by some competitor. (R., 1381, 1382.)

The undisputed testimony in the case shows that it is

not practically possible to get the company's gas supply for five years forward out of the No. 1 leaseholds even with a continued supply from West Virginia and other purchosed gas sources. (R., 1052 to 1054; Reply Brief 608, p. 56.)

The only witness the city introduced in respect of The Ohio Fuel Gas Company's leaseholds was J. Paul Blundon. At record, 1416, we asked Mr. Blundon:

> "Q. Are you competent to answer the question as to whether The Ohio Fuel Gas Company needs any reserves other than its No. 1 leaseholds to discharge its obligation to customers in the state of Ohio? A. I am not competent to answer that question at this time.
>
> Q. Well, you were not competent when you made the allocation, were you, that is, to answer that question? A. No, sir."

The undisputed evidence in this case, from thoroughly competent witnesses, (some of whose testimony has been set forth at pages 76, et seq. of our Opening Brief in Case 608) is that The Ohio Fuel Gas Company could neither be organized, financed nor successfully operated without all of its present reserves, which are therefore all now used and useful in producing and transporting natural gas. (R., 1380 to 1383, Weymouth; 1119 to 1123; 1137, Dally; 1194 to 1197, Wittmer; 1302 to 1303, Webber.)

We showed a long list of companies which failed because they did not have sufficient reserves. (Co. Ex. 57, pp. 8 and 9; R., 1052.)

In 1914 appellant was forced to enter into a supply

contract (Co. Ex. 12; R., 2884) because its own gas lands had become exhausted and it found itself without reserves to carry on.

The amount of reserve acreage necessary to support a natural gas producing and transporting company is, of course, relative to the size of the enterprise.

The question of gas reserves cannot be understood without an understanding, inter alia, of:

(a) The location and characteristics of the gas sands in Ohio. (R., 1329-1334.)

(b) The location, needs and obligations of The Ohio Fuel Gas Company to the more than 300 communities in Ohio supplied by said company. (Co. Ex. 45, pp. 6-9.)

(c) The location and extent of competitive operations. (See Co. Ex. 142, 143, 144, original.)

(d) The location of and investment in the company's 38 compressor stations. (See Map R., 3058 B, described R., 1770, 1787 to 1794; Co. Ex. 45, pp. 10-11.)

(e) The location and size of and investment in the company's 5633 miles of transmission lines. (Co. Ex. 45, p. 10; see Map R., 3058 B, described R., 1787 to 1802.)

(f) What additional compressor station equipment will be needed if the company be confined to No. 1 acreage? (R., 1052, et seq.)

(g) What additional off-set wells will have to be drilled if the company be confined for five years forward to No. 1 leaseholds? (R., 1052, et seq.)

(h) Is it possible to get the company's supply for five years forward out of the No. 1 leaseholds? (R., 1052, et seq.)

There are 38 compressor stations with a total of 64,620 horse power. (Co. Ex. 45, pp. 10-11, original.)

There are 5633 miles of transmission lines. (Co. Ex. 45, p. 10.)

There are 979 miles of well lines. (Co. Ex. 45, p. 10.)

The rights of way for the well and transmission lines are the same length as the pipe lines. (Co. Ex. 45, p. 15.)

There are 335 miles of telegraph and telephone lines.

The annual sales for 1929 were 53,579,575 M c. f. (R., 217.)

In its opinion the commission in the instant case said: (R., 148)

> "The commission has had opportunity to examine expensive equipment including powerful compressor stations where batteries of from eight to sixteen engines, each of 1500 horse power, force the gas that has been collected from widely separated wells, under high pressure, to the place of consumption through hundreds of miles of transmission pipe of large diameter.
>
> The commission has gained some conception through many expert witnesses, having undoubted skill and experience, of results accomplished by the intelligent expenditure of capital in an enterprise whose hope of reward rests upon its ability to furnish to many small consumers a commodity, the enjoyment of which is eagerly sought. The commission has been impressed with the fact that this great natural resource could not have benefited the consumer unless there had been an intelligent application of capital to its development and transportation.
>
> * * * * * * * * * * * * * * *

(R., 155): "It is urged by the company that a

wise business policy dictates that future requirements must be provided for to justify the expenditure of large sums of money in transportation and distribution facilities. It is insisted that the control of large reservoirs of gas for future use is the very foundation of the stability of the company and that without such reserve the company could not in justice to itself spend the sums necessary for transmission lines and for distribution within municipalities. It is insisted that it would be the height of folly to venture large sums which would be lost to the company if it were deprived of the back-log of gas reserves, and it is pointed out unless the company secure to itself these gas lands for future development, a rival company might come into the field and lease the lands placing the present company at the mercy of its rival, when it has exhausted the gas beneath what is now designated as productive acreage."

It must occur at once that the question of gas reserves is necessarily one to be settled primarily by the management. Whether there has been an abuse of managerial discretion is, of course, a question for the courts. There was not the slightest question raised as to the propriety of The Ohio Fuel Gas Company's reserves. The commission felt itself bound by the case of **Logan Gas Co. v. Public Utilities Commission**, 121 Ohio St., 507, which case is still pending before the commission. The court below adhered to its decision in the Logan case.

We have had certified to this court a series of original exhibits, which need to be carefully studied in connection with the question of the necessity of reserve leaseholds. These are:

Exhibits: 139—which is an epitome of the leaseholds of The Ohio Fuel Gas Company on a map in color showing the location of the territory in townships in the various counties. (This exhibit is briefly described at R., 1124 and 1327, et seq.)

141—is a summary of the gas wells and leases as of June 30, 1929 (the date certain used for gas leaseholds). (This exhibit is briefly described at R., 1322.)

142, 143 and 144—are map books of the gas leaseholds as of June 30, 1929. (These are briefly described at R., 1322, et seq.)

145—Summary of the gas wells as of June 30, 1929. (Briefly described at R., 1323, et seq.)

146, 147 and 148—Detailed list of the gas leaseholds of The Ohio Fuel Gas Company. (These are briefly described at R., 1325, et seq.)

149—A set of the lease forms.

153—A small map of the gas pools. This is a condensed map. We did not certify the larger maps because of their size. (See R., 1334.)

154—A cross section diagram of the various sands. (R., 1334.)

155—A specimen lens. (R., 1334.)

A hasty look at these exhibits will convince the court that volumes could be readily written upon this subject of reserve leaseholds.

Briefly, the pay sands are located in the eastern part of the state of Ohio and run from the Ohio river to Lake Erie. (R., 1329, et seq.)

Gas Reserves.

During the years 1926, 1927 and 1928 practically all of the gas reaching Columbus was produced in the Cambridge field, deliveries being made through Treat Station ("north-east of Columbus") and Line B to Columbus. At the time of the hearing of this case the Cambridge field could deliver only three million cubic feet a day with the aid of four compressor stations, as compared to its 1926 peak of sixty million cubic feet per day without the aid of any compressor station. (R., 1783.)

In Company Exhibit 176 (original) will be found a list of the gas rate ordinances and schedules of various municipalities and locations in Ohio served by The Ohio Fuel Gas Company, on file with the commission.

Company Exhibit 45 (original), pp. 6 to 9, inclusive, contains a complete list of the communities in Ohio served by The Ohio Fuel Gas Company. (See also R., 1811.)

The original exhibits above mentioned, particularly 139, 142, 143 and 144, will show that the gas leaseholds of The Ohio Fuel Gas Company are interspersed or checker-boarded with the gas leaseholds of others, and that natural gas may be and/or is transported from such production territories to markets other than those supplied by The Ohio Fuel Gas Company.

At pp. 107 and 108 of our opening brief in Case 608 we have quoted some of the testimony showing that the leases are checker-boarded with the leases of competitors.

The location of the 38 compressor stations is shown on the map R., 3058 B and at pp. 10 and 11 of Company Ex-

hibit 45 (original). These compressor stations are described in narrative form at R., 1770 and 1787 to 1794.

The location of the transmission lines is shown on the map R., 3058 B and described in narrative form at R., 1787 to 1802.

With the foregoing sketchy observations in mind, let us look at the amount of reserve acreage carried by The Ohio Fuel Gas Company, and which all of the witnesses in the case who attempted to testify on the subject said were necessary and presently used and useful as part of the creation, financing and operating of The Ohio Fuel Gas Company.

As compared with the 291,396 acres of No. 1 partially exhausted territory, there are 164,739 acres of No. 2 and 312,631 acres of No. 3, scattered through 29 different counties in the state, protecting a reproduction new investment of more than ninety millions of dollars.

No. 2 are leases of tracts proved by actual developments and operations in the immediate neighborhood to be good gas producing lands.

No. 3 are leases of tracts shown by surrounding developments and geological considerations to be reasonably certain to be gas producing lands.

The largest class is the No. 4, which consists of 2,065,421 acres situated within areas where gas sands are known or assumed to exist from general geological considerations. The lowest value testified to for these leaseholds is $2.00 per acre, or $4,130,840.00. That barely sustains the original cost payment and the overhead

necessary to secure the lease, to say nothing of carrying charges.

The valuations were put upon these reserves with the knowledge that it will be necessary to pay the delay rental until such time as productive wells are drilled. (R., 1114; 1237; 1299.)

Surely it cannot be said that in holding this acreage of leaseholds to meet the demands of the public and the public's very large investment in gas burning equipment, the management has abused its discretion.

When the leasehold exhibits and testimony are understandingly examined, it will be found not only that there has been no abuse of discretion, but as said by the commission (R., 148):

> "* * * there has been an intelligent application of capital to its development and transportation."

In the **dissenting opinion in the court below** Judge Jones said (R., 74):

> "* * * The theory advanced that a tract held in reserve may be capitalized only if and when it is being actually operated is obviously unsound. It might as well be argued that a set of steam boilers, held in reserve for unforeseen contingencies but not presently operated, should not be valued until they were being put into actual use. The utility's gas territory is its chief and necessary asset; its extent being measured by the requirement of all the communities which it is called upon to serve and the reasonable cost of service should be allocated among them. * * * Because of the peculiar hazards of the business and of inevitable gas exhaustion resulting in so short a period as that found by the

commission (being presently three years and two months), ordinary business sense would require a reasonable gas tract reserve, in addition to the tract that is being actually operated, in order to supply the public's future needs. That situation, which is now so evident, did not so clearly appear when we decided the case of Logan Gas Co. v. Public Utilities Commission, 121 Ohio St., 507."

When the case of **United Fuel Gas Co. v. Railroad Commission**, 278 U. S., 300, was before the District Court, Judge Hickenlooper said (13 Fed. [2d], 510, 515):

"We think that it must be conceded that the company has a right to hold, as used and useful in its business, reserve or undeveloped gas acreage, in which to prospect for gas. Much of this may prove unprofitable, but it is necessary for the continuance of the life of the business."

In the case of **Wichita Gas Co. v. Public Service Commission**, 2 Fed. Supp., 792, it was said (p. 808):

"Who shall determine what reserves are adequate? A commission, with no moneys invested, or the owners of this pipe line which, without gas, is worse than useless? Within the limits of reason, undoubtedly that determination must be left with the owners. Perhaps they have been over cautious, but if error is to be made, it should be on the side of ample reserves. The owners of this property had seen the gas exhausted from field after field; they had seen their customers lost because the supply had failed; they had seen fields of great promise belie their expectations. They had seen geologists wrong before."

The company can never get its money back through the capitalization of delay rentals when the particular tract becomes productive because only one out of ten acres ever becomes productive and it is necessary continually to lease and surrender acreage.

Had the annual expense of delay rentals—Account No. 360, been allowed, as we claim it should have been allowed, the gate price would have been increased 3.1447 cents per M c. f., and the Columbus rate would have been increased 3.3019 cents.

Had the lowest valuations been allowed for Classes 2, 3 and 4 reserve acreage at a 6½% return it would have increased the gate price 1.852 cents and the Columbus rate 1.9446 cents.

In the table on page 273 of our opening brief in Case 608 we have listed the increases at rates of return up to the 8% which we believe a natural gas producing and transporting company is entitled to earn.

PRESENT VALUE OF GAS WELLS.

(Pages 132 to 146, Opening Brief and 48 to 53, Reply Brief, Case 608.)

Majority Court Opinion, R., 71.

Dissenting Court Opinion, R., 74.

Majority Commission Opinion, R., 161.

Minority Commissioner's Opinion, R., 202.

Gas wells consist of two accounts, No. 211—Gas Well Construction and No. 212—Gas Well Equipment. (R., 180.)

The new value of these accounts was arrived at by the Ohio statutory cost of reproduction new method, which method gives no consideration whatever to the gas content of the well.

If gas content be considered, it must be readily apparent that while the construction and equipment is of scrap value only if the hole is dry, the well's value is proportionate to the flow of gas discovered. Two wells may have the same cost for construction and equipment, yet if one results in a two million cubic feet flow it is certainly worth more on a gas content basis than one with only one million cubic feet or half as much flow. (R., 1514.)

The present value was found below by disregarding observed depreciation and in lieu thereof by deducting from the cost of reproduction new a percentage equal to the estimated depletion of the gas under the wells, which resulted in a reduction of $10,387,311 from the cost of reproduction new less observed depreciation. (R., 180; cf. Co. Ex. 45, p. 29, R., 2912.)

Whatever might be said in favor of the "rock pressure decline method" could be justified only where both the original value and the present value had been obtained by that method rather than, as in the instant case, by the use of two different methods, each of which produces a lower valuation at the respective points.

This rock pressure decline method of obtaining the present value only was adopted by the commission upon the assumption that it was the method followed by the

Public Service Commission of West Virginia. No attention was paid to the fact that the West Virginia Supreme Court of Appeals had reversed the West Virginia commission in the case of **City of Charleston, et al. v. Public Service Commission**, 110 W. Va., 245, wherein it was stated (R., 3031):

> "It was stated in argument by counsel for the utility that the cost of well equipment was fixed at 46% of the original cost, no matter whether the wells were new or old. We suggest that the commission review again the evidence as to the wells; and unless there is a sufficient number of old wells to offset the new wells, then the value of the equipment be adjusted in some more uniform manner."

After the above decision in the **Charleston case**, the Public Service Commission of West Virginia abandoned this mixture of systems. In the case of **Wheeling v. Natural Gas Co. of West Virginia**, P. U. R. 1933D, 1, the West Virginia commission said at page 33:

> "The method employed by Ford, Bacon & Davis appears to be more agreeable to reason than the rock pressure decline method, and we will calculate the present condition of the gas well account at 82.9 per cent. of the condition of the property new."

While the city introduced the opinion in the **Charleston case** (R., 3020), they seem either not to have read it or to have forgotten what was in it, for they say in their brief in Case 608 at page 187:

> "In the United Fuel Gas case in West Virginia where both Lerch and Blundon testified on the sub-

ject of gas well depreciation, Blundon's method of depreciating both gas well construction and gas well equipment on the basis of decline in rock pressure was adopted by the Public Service Commission. (R., 2958.)''

For this to have been a correct statement counsel should have added:

and reversed by the Supreme Court of Appeals of West Virginia (R., 3031; City of Charleston, et al. v. Public Service Commission, 110 W. Va., 245), **and not followed by that commission in a later case where the same witnesses again testified.**

As the Public Service Commission of West Virginia in the case of **City of Wheeling v. Natural Gas Co. of West Virginia**, supra, has now adopted what we believe to be the correct method of gas well depreciation, we shall adopt as our argument the opinion of that commission in explaining its change of position on the ''rock pressure decline method'' of gas well depreciation, as follows (p. 32):

> ''In the United Fuel Gas Company case (1930) supra, the commission followed an earlier decision (Re Clarksburg Light & Heat Co. (1927), 2 W. V. P. S. C. Decisions, 611, P. U. R. 1928 B, 290) in giving effect to evidence of depreciation on the city's present theory. In reviewing that case the Supreme Court of Appeals remarked that the value of 'well equipment was fixed at 46 per cent. of the original cost, no matter whether the wells were new or old,' and directed that we 'review again the evidence as to wells, and unless there is a sufficient number of old wells to

offset the new wells, then the value of the equipment be adjusted in some more uniform manner.'

"This is the first case involving this question since the directions of the court were given, and in which evidence has been adduced in support of the company's method of depreciation, supported by convincing evidence of the actual physical condition of the gas well property as an element of the plant that is useful for the transmission of gas, as a pipe line is useful to carry the fuel from the point at which it is found by the producer to the point at which it is needed by the consumer. In the light of the review of this subject which the testimony of those who assisted in this investigation affords, it would appear that the physical condition of the well property should be ascertained, if it is possible to do so by any dependable method. Property is not necessarily to be treated in an arbitrary depreciated condition merely because its present use will be completed at a more or less determinable future date. Certain parts of the equipment of wells are recoverable, and are used again in new wells or in pipe lines, just as other equipment may be moved from place to place as the prudent management of a plant may require. So long as such property is used and useful, the owner is entitled to compensation for its use based upon its actual present value as property. A piece of equipment may be installed within a year before the entire plant is retired from service on account of failure of gas supply, and it may be in 99 per cent. condition when the service ceases. If its installation was essential to the service of the public, there seems to be no good reason why the owner's compensation for its use should not be based on its fair value at the time the service is rendered. The fact that it is to go out of service within a year, even if that fact were known, does not make it any less valuable at the

time it is used, nor does it lessen the sacrifice of the owner in installing it.

"Further investigation of the rock pressure decline method of estimating the present condition of a gas well has disclosed the inaccuracy of the results obtained from the data used by the city's engineer. So much depends upon the history of prior production of the wells, the quality and location of the various sands, the time and manner of taking the pressures, and numerous other factors which may affect the result, that accuracy is impossible under the method used by the city in this case. And if all this information were available, no light would be thrown upon the actual condition of the well property as such or upon its present fair value for rate-making purposes.

"The question remains whether the investigation made by the company's engineers was of the proper character and sufficient in extent to ascertain correctly the depreciated condition of the gas wells. Material from nine wells just abandoned was inspected. The oldest of these wells was drilled in 1907, the latest in 1924. Of the company's 399 wells, 22 were drilled before 1907 and 84 have been drilled since 1924. If the material was new when installed, the wells that were inspected may reasonably be assumed to constitute a fair average for those now in use, and if not new when installed, then their condition might be assumed to be even poorer than that of the remaining wells."

In the discussion of the subject of gas well depreciation at page 132 et seq. of our opening brief in Case 608, we have quoted from R., 495, showing that the city's expert had no qualification to propose this method of ascertaining present value of gas wells.

At page 141 of that brief we have by a hypothetical example shown the ridiculous results to be obtained by the application of the method adopted below. That such results are actually obtained by the use of the method adopted below, we call attention to cross examination of the city's engineer at R., 1522.

At R., 1514, the city's engineer testified:

> "The Witness: The flow of a well new is not in proportion to the rock pressure obtaining in that well; in other words, it is perfectly possible to drill in a well and get a larger volume of gas with a 200 pound rock pressure than some well with a 500 pound rock pressure; but after that well is in and it comes in at 200 pound rock pressure, we will say, its value as a well depreciates in proportion to its decline in rock pressure."

The record in this case shows that wells at the same rock pressure have vastly different open flows. In other words, where two wells come in at 500 pounds initial pressure one of them may have twice as much open flow as the other. The construction of both of these wells cost the same. A few years later both of these wells have declined to 250 pounds pressure. Notwithstanding the fact that one is producing twice as much gas as the other, the rock pressure decline method would value these wells each at 50% of their cost of reproduction. (See cross examination of city's engineer, R., 1523.)

We have had certified as original exhibits Company Exhibits 183, 187, 189, 190 and 192, showing the application of the rock pressure decline method to the company's

wells. These exhibits are explained beginning at R., 1548. They demonstrate that well pressures taken at different times give wholly different results for the same well. In other words, we are here opposing theory with facts.

At page 17 of Company Exhibit 45 (original) and at R., 1530, the Ford, Bacon & Davis method of ascertaining present condition of the gas well accounts is explained. This method depends upon observation and a study of all the conditions which contribute to deterioration of the wells.

At R., 1530, Mr. F. H. Lerch, of the Ford, Bacon & Davis organization, testified upon cross examination as follows:

> "A. The method is based upon a consideration of the wells as items of physical equipment and to determine the depreciation from all of the facts which we can gather concerning the condition of the wells as items of physical equipment, and from those facts to determine a percentage which is fair and reasonable in our judgment.
>
> Q. Which, translated, means what? A. It means that we are endeavoring to place an observed condition upon the wells."

We are here asking the application of the doctrine of this court laid down in the case of **McCardle v. Indianapolis Water Co.**, 272 U. S., 400; and **Pacific Gas & Electric Co. v. San Francisco**, 265 U. S., 403.

In the **Indianapolis Water case** this court, by Mr. Justice Butler, said, at page 416:

> "The testimony of competent valuation engineers, who examine the property and make estimates in respect of its condition, is to be preferred to mere calculations based on averages and assumed probabilities." (Citing cases.)

In the **Pacific Gas & Electric case**, this court, by Mr. Justice McReynolds, said at page 406:

> "Appellant objects to the application of this method, and insists that depreciation should have been ascertained upon full consideration of the definite testimony given by competent experts who examined the structural units, spoke concerning observed conditions, and made estimates therefrom. As these examinations were made subsequent to the alleged depreciation, for the definite purpose of ascertaining existing facts, we think the criticism is not without merit. Facts shown by reliable evidence were preferable to averages based upon assumed probabilities."

Had the observed depreciation method been applied to the gas well accounts it would have added 1.3231 cents to the retail rate based upon a 6½% return. For results under other rates of return see page 275 of our opening brief in Case 608, and for the method of computation see pages 145 and 146 of said brief.

DEPLETION—AMORTIZATION.

(pp. 34 to 64 Opening Brief and 42 to 47 Reply Brief Case No. 608.)

Majority Court Opinion, R., 65 to 72.

Dissenting Court Opinion, R., 73.

Majority Commission Opinion, R., 158 to 161.

The 48¢ rate contains no allowance for the depletion of the gas fields and/or gas wells.

The court below erred in reversing the commission for allowing depletion on three acounts: 205—Leaseholds, 211—Gas Well Construction, and 212—Gas Well Equipment, all of which are wasting assets. Natural gas is not regenerative.

It is our contention that in addition to the error committed in allowing no depletion on wasting assets, the court below erred in not making an allowance sufficient to amortize the property used in producing and transporting natural gas.

At R., 67 in the **majority court opinion** below it is said:

> "That the product natural gas will eventually die is self-evident. When it will die is an assumption."

We introduced through competent witnesses evidence showing that the supply of natural gas in Ohio was not sufficient for more than an additional period of 25 years.

For instance, on cross-examination the witness Seyffert testified as follows (R., 1480):

> "Q. * * * You say the present estimate of the probable life of the natural gas business based on extensive surveys, geological studies, well pressure decline and analysis, etc., indicates a probable life of 25 years? A. Yes, sir."
>
> (R., 1489) "Commissioner Bricker: What else would you set up amortization on except leaseholds? The Witness: Set up amortization on the whole property, because when the gas is gone, the rest of the property will be of no value to the stockholders."

The city introduced no evidence of any kind in respect of the probable life of either The Ohio Fuel Gas Company or the natural gas industry in Ohio.

The company claimed a 4 per cent. allowance for amortization.

With the exception of a small fraction of a cent the entire difference between the 48 cent ordinance rate, affirmed, and the 55 cent commission rate, reversed, is due to two items in the gate price:

(a)	Allowance on account of depletion	5.7129 cents
(b)	Difference in treatment of West Virginia expenses, ...	1.2284 cents
		6.9413 cents

The majority commission's gate price, reversed by the court, was 39.02 cents (R., 179) while the minority commissioner's gate price was 31.70 cents (R., 217).

At R., 158 the commission said:

> "While there is no statutory provision covering the item of depletion, yet it is apparent that it should be treated substantially in the same manner as depreciation defined by the statute, and we may designate it rather inaccurately 'amortization.'"

The court below, entirely misunderstanding the allowance for depletion, which the commission said they designated "rather inaccurately 'amortization'", thought the allowance had something to do with valuation. In the **majority court opinion below** the question is asked (R., 72):

> "How can an allowance for new production and amortization be reconciled?"

The obvious answer, of course, is that there is no connection or relation between the two.

In his **dissenting opinion in the court below**, Judge Jones said (R., 73):

> "Although the commission made a partial allowance therefor, the majority decision permits no allowance for depletion or amortization of utilities in cases such as these, where the annual drain upon their gas field resources by way of gas depletion is so heavy, eventually amounting to total exhaustion. Such decision, in my judgment, where a low rate is fixed, tends to pure confiscation of property."

In reviewing the holding of the court below in the instant case, the **Yale Law Journal** in its January, 1934 issue, at page 483, says:

> "Regulation of the rates of natural gas utilities is complicated by the consideration that since they ex-

ploit a wasting asset they do not, in theory, contemplate a perpetual life. The service life not only of the production but also of the transmission properties is limited by the life of the gas fields from which the company draws its supply. Difficulties inherent in accurate prediction of this life have induced some commissions to dispose of the problem summarily by permitting such utilities to earn an unusually high rate of return. But precision demands that the income be resolved into its elements. The company is entitled to earn, in addition to a fair return and a fair allowance for depreciation and current maintenance, an amount sufficient within the probable life of the business to repay the investor the entire capital investment less salvage at the end of its present use.

In a recent case the Supreme Court of Ohio revealed an unfortunate lack of comprehension of these problems."

Outside of the depletion allowance made by the majority commission and reversed by the court, it will be impossible to find any allowance in this case for depletion or any cushion which could be substituted therefor. Yet counsel for the city, recognizing their desperate situation on this question, attempt to answer our opening brief in Case 608 by saying at page 13 of their brief:

"(1) At page 15 it is stated that while the majority of the commission made an allowance for depletion of gas leaseholds and gas wells, the minority made no such allowance. This assertion is incorrect. The language of the minority commissioner cannot properly be given such construction." (R., 205.)

Then at page 189 of the city's brief counsel, under the title of "Amortization", launch into a discussion of various claims of The Ohio Fuel Gas Company which were disallowed. Recognizing the weakness of their position, they say at page 203:

> "While it is true that amortization has never received legislative recognition in Ohio, if what is claimed as amortization constitutes some form of depreciation it may be included in the operating expenses under the Ohio statutes as construed by the decision of the court in this case."

This is truly a remarkable statement in face of the language of the court below, where, after discussing the depletion allowance made by the majority commission and quoting from the language of the commission on how such funds should be invested, the court below said (R., 72):

> "But we just cannot read amortization into the law of Ohio."

This was no slip of the pen. It was a repetition of what the court had said on preceding pages.

At R., 58, in discussing the amortization allowance by the West Virginia Commission, which was adopted by the majority of the commission below (R., 150) but rejected by the minority commissioner (R., 193), the court below said:

> "With reference to the item of depreciation and amortization, the West Virginia Commission allowed 1.12 per cent. for depreciation and 4.15 per cent. for amortization. These figures were carried over into

their findings by the majority commission. We hold elsewhere in this opinion that amortization cannot be allowed under Ohio law. The Ohio statute provides for an allowance for depreciation but not for amortization. Section 499-9, General Code. The commission has no discretion in adding items of valuation not specified by the Legislature.

We therefore find that the river rate of 17.79 cents for gas delivered from West Virginia, fixed by the minority of the commission, is not unreasonable, unlawful, nor confiscatory."

At R., 150, the majority commission, in discussing this same matter, said:

"The West Virginia Commission treated the question of depreciation and amortization by allowing a certain per cent for each of these items, to-wit, 1.12% for depreciation and 4.15% for amortization, such per cents being estimated upon the property subject to these items. This method of computation was endorsed by the Supreme Court of West Virginia. On all other items of expense for the operation of the United Fuel Company the commission is in harmony."

The minority commissioner said at R., 193:

"I have taken the facts as tentatively determined in that case by the West Virginia Commission and as shown by the record and have applied to them the principles used in the determination of the value of the Ohio Fuel Gas properties and with the allowances for expenses comparable to those allowed in the Ohio Fuel Gas case, which principles will be hereinafter discussed."

The minority commissioner eliminated entirely the 4.15% for amortization of the West Virginia property.

The only deduction to be made from the quotation from page 13 of the city's brief, supra, is that the minority commissioner allowed depletion. That is just as remarkable a statement as is the one to the effect that amortization may be "included in the operating expenses under the Ohio statutes as construed by the courts in this state."

Before continuing with the pointing out of the minority commissioner's position, we desire to call attention to the argument of the city (p. 204, et seq. of city's brief in Case 608) that the majority of the commission calculated the depletion allowance upon the basis of wells that had gone out of existence, instead of on the basis of wells that were still producing. We maintain that the majority commission used the proper basis for the calculation of the depletion allowance, but there is no allowance of any kind even on the city's basis in the 48 cent rate.

The city's engineer conceded depreciation for The Ohio Fuel Gas Company's property at the rate of 3.6%. When asked about amortization, the city's only witness, Mr. Blundon, testified at R., 1768:

"I don't agree to the principle of amortization."

Counsel for the city conceded that the annual depreciation for The Ohio Fuel Gas Company should be $2,848,301.74. (R., 160.)

In the face of this concession the minority commissioner allowed only $1,765,607.00 for depreciation. (R.,

217.) While in the form of exhibit to the findings it is called "Depreciation and Amortization", a review of the opinion of the minority commissioner shows clearly that he was providing for nothing but normal depreciation and obsolescence.

At R., 192, the minority commissioner said:

> "The commission therefore can approach this problem without giving consideration to the life of the property other than as to those factors resulting from normal depreciation and obsolescence."

At R., 205, the minority commissioner said:

> "I have, in computing an allowance for depreciation and amortization, used 2½% of the value of the property, excluding land, working capital and material and supplies, which reduces the amount claimed by the company in the sum of $5,103,855.00. A complete study has been made of the depreciation charges of the company which show for the year 1929 an unexpended depreciation reserve in the sum equal to 22.20% of the book value of the company's property.
>
> It is my opinion, therefore, that an allowance of 2½% on the value of the property of The Ohio Fuel Gas Company **is a reasonable allowance for depreciation** in view of the fact that there has been allowed completely the company's figures for maintenance, including non-productive well drilling expense.
>
> These amounts are sufficient, when taken together, to maintain the property in a high standard of efficiency **and to provide a reserve to take care of the property as it wears out and to ultimately provide for the complete replacement of the property.**" (Boldface ours.)

The minority commissioner was assuming a continuous life of the business. A 2½% allowance assumed an average life of forty years. But this in nowise was meant for either a depletion or amortization allowance. It was, as stated in plain words, to maintain the property in a high state of efficiency and to provide replacements of the property. Of course, if there were no maintenance or replacements to be made for the next forty years, and the business lasted that long, it could be said that an amortization fund had been provided for. However, all that has been provided for is the upkeep and replacement of the property. It does not matter in how good a condition the property may be at any future period if there is no gas, because if there is no gas the property has only a scrap value. It is doubtful if the realization for scrap would pay the cost of salvage.

In an attempt to find a cushion which can be used for depletion counsel for the city at page 217 of their brief in Case 608 claim that when their witness Blundon submitted his depreciation factor of 3.6% it was done without a consideration of the existing depreciation reserve.

The record will show that the figures of the depreciation reserve were introduced in the case months before Mr. Blundon appeared. That a consideration of the depreciation reserve is unfavorable rather than favorable to the contention of the city is shown not only by the reference thereto in the above quotations from the minor-

ity commissioner, but from the following quotation from the majority commission opinion at R., 160:

> "The figures arrived at through appraisement as compared with those arrived at through an examination of the books show an excess of approximately $8,000,000.00 as disclosed by the appraisal **which would indicate that the company has set up on its books a sum less than actual experience indicated should have been set up.**" (Boldface ours.)

Company Exhibit 177 (R., 2999) referred to by counsel for the city shows that the ratio of reserve to book investment has been decreasing. At the end of 1928 it was 22.73%; in 1929 it was 22.20%, and in 1930 it was 21.19%.

At page 196 of the city's brief in Case 608 they say:

> "Ohio Fuel and its predecessors have been in existence for approximately 30 years * * *."

Need we argue further then that that company's depreciation reserve is inadequate rather than excessive?

At page 216 of the city's brief attention is called to a reported surplus of $5,288,031.10 as of December 31, 1929. (R., 2902.)

Even if this were a thoroughly accurate statement, it would be a very modest surplus for a company that had been in existence as long as the city claims the Ohio Fuel and its predecessors have been. However, an examination of the balance sheet at R., 2902 reveals that the earned surplus is $3,073,712.56. The balance is the

> "Excess of Logan Gas Co. net assets over par value of stock issued for same."

(There is a typographical error on R., 2902. The word "loan" should be "Logan"—the letter "g" is left out.)

Instead of "writing up" the Logan assets (and this includes the leaseholds) when taken over, the Logan surplus was added to the Ohio Fuel surplus.

Because the error of the court below in the matter of depletion and amortization is so obvious, we feel justified in omitting further argument. However, we have in our briefs in Case 608 gone into more detail, made arithmetical calculations and quoted authorities.

We have searched the authorities diligently and can say without fear of successful contradiction that there is no case in the country, outside of the instant case, in which the court has denied an allowance for wasting assets or disallowed amortization of the facilities used in a limited life enterprise.

The most recent discussion of depletion by this court is to be found in the income tax cases decided January 15, 1934. (Helvering v. Falk, No. 225; Reynolds v. Cooper, Nos. 227 to 229; 290 U. S.)

Had depletion of the operated leaseholds and gas wells been allowed it would have increased the gate price 5.7129 cents and the retail rate 5.9985 cents.

Had depletion been allowed on operated leaseholds and gas wells (Accounts 205, 211 and 212), and amortization at 4 per cent. on the balance of the property, other than land, working capital and materials and supplies, it would have increased the gate price 9.5794 cents and would have increased the retail rate 10.0538 cents. (See computation pp. 263-264 Opening Brief Case 608.)

WEST VIRGINIA PROPERTY OF UNITED FUEL GAS COMPANY.

(pp. 85 to 92; 238 to 240; and 245 to 249 Opening Brief Case 608.)

Majority Court Opinion, R., 51, 57.
Majority Commission Opinion, R., 150.
Minority Commissioner's Opinion, R., 193.

The court below erred in holding that the property of United Fuel Gas Company located in West Virginia and Kentucky should be valued and the expenses of that company should be ascertained according to Ohio law (R., 51, 57), which is in conflict with the law of West Virginia as declared by the highest court of that state.

The holding below impairs the obligation of a contract (Co. Ex. 58, R., 2915) between The Ohio Fuel Gas Company and United Fuel Gas Company, whereunder the Ohio company purchases gas produced by the United in West Virginia and Kentucky at the Ohio-West Virginia state line.

In the case of **Smith v. Illinois Bell Telephone Co.**, 282 U. S., 133, this court said (p. 148):

> "The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of competent governmental authority in each field of regulation."

Appellant does not purchase any gas from United. The Ohio Fuel does purchase a portion of its supply

(29% in 1929) from United under a contract which conforms to the holding of the state and federal courts of West Virginia, and which contract provides for the same price as charged by United to unaffiliated companies for similar quantities of gas.

In support of the foregoing contention, and as proof of the fair market value of the West Virginia and Kentucky gas, we introduced Company Exhibit 59 (R., 2920), which is an arm's length contract between United Fuel Gas Company and Hope Natural Gas Company (unrelated), whereunder United sells to Hope similar quantities of gas, with similar deliveries, at approximately the same average price which United charges the Ohio Fuel, to-wit, 26½ cents per M c. f. We have used the word "approximately" for the reason that the Hope contract price works out to be slightly higher than the Ohio Fuel contract price.

The city made a motion to require appellant to introduce the valuation and expenses of United Fuel Gas Company, and upon consideration thereof the commission required appellant to introduce, in the instant case, a complete copy of the record of the Public Service Commission of West Virginia in a rate case then pending before said commission involving the rates of United Fuel Gas Company.

In considering the expenses to be allowed in the fixation of West Virginia rates, the West Virginia commission (R., 2963; Co. Ex. 78, p. 21) had allowed the cost of carrying reserve leaseholds and 4.15 per cent. for amorti-

zation, both of which allowances had been approved by the Supreme Court of Appeals of West Virginia in the case of **City of Charleston, et al. v. Public Service Commission**, 110 W. Va., 245 (City Ex. 30, R., 3020).

The court below held that even though all of the property in question was located outside of the state of Ohio and was used to serve consumers in the state of West Virginia, said property should be valued and the expenses connected therewith should be allowed only in conformity with the laws of Ohio as interpreted by the court below, which laws so interpreted were contrary to the laws of West Virginia as interpreted by the court of last resort of that state in the case of **City of Charleston et al. v. Public Service Commission**, supra.

If the holding of the court below be followed it will tend to make West Virginia rates confiscatory.

In the case of **Charleston, et al. v. Public Service Commission, et al.**, 95 W. Va., 91, it was held that if United Fuel Gas Company sold natural gas to its related companies at less than the fair market rate it should be treated as if it had received the fair market rate for such gas.

The eighth branch of the syllabus in the foregoing case is as follows:

> "8. A natural gas utility should not be allowed to sell its gas to its parent companies at less than its fair market value, and where it does so, in a proceeding to determine gas rates for the utility, it should be treated as receiving a fair market rate for the gas delivered to the parent companies."

West Virginia Property.

Notwithstanding this holding by the Supreme Court of Appeals of West Virginia, this matter continued to be a bone of contention and was raised again before the West Virginia commission in Case 1516—**Re United Fuel Gas Company**, P. U. R. 1925B, 705, 753. The record in this case before the commission was introduced as the record before the three-judge District Court in the case of **United Fuel Gas Co. v. Public Service Commission of West Virginia**, 14 Fed. (2d), 209, where the question was again raised. This last mentioned case was appealed to this court and decided **278 U. S., 322.**

The official report of that case in this court shows that it was contended by counsel for the company that the court below had erred by adding to the earnings of that appellant the sum of $1,495,496.69 as additional compensation, which it was held should have been charged to The Ohio Fuel Supply Company and Columbia Gas & Electric Company for gas sold them in excess of the price actually charged and received.

In the resumé of the brief for appellees it is also stated in said official report:

> "In adjusting the earnings of the gas company for the year 1923 the commission and the court below added to the earnings as reflected by the company's books the sum of $2,143,661.46 (not $1,495,496.69) on account of the sale of gas to the parent companies, which was equitable and proper. Charleston v. Public Service Commission, 95 W. Va., 91; 120 S. E., 398."

While the point was thus argued by both sides, this court did not separately discuss this question, but did say:

> "With respect to other conclusions of the court below, there is no serious suggestion that the court below abused its discretion. In 1923 the case was before the highest court of the state. * * * We think it clear that no case is presented which would warrant interference by this court with the order below denying interlocutory relief."

When that case was before the West Virginia commission (P. U. R. 1925B, 705) it was stated as one of the questions for determination (p. 711):

> "VII. What is the annual revenue and annual expense of the gas company, involving what amount of income, if any, the gas company should be charged with receiving from the sales of gas to its parent companies?"

At page 753 the commission said:

> "Agreeable to the former holdings of this commission and the decision of the Supreme Court of Appeals in Charleston v. Public Service Commission, supra, certain adjustments must be made in these net earnings. We refer * * * to the receipts from gas sold by the gas company to its parent companies the Columbia Gas & Electric Company and The Ohio Fuel Supply Company."

(The record in this case was made the record by the court below in the case decided by this court, 278 U. S., 322.)

As the valuation in the record introduced below was

for the year ending December 31, 1928, appellant also introduced Company Exhibit 80 (R., 2965), which shows at page 3 that with the additions at cost to the property of United Fuel Gas Company made subsequent to the date certain of the West Virginia rate case, with going concern value eliminated, and with book value only for the gas leaseholds, a price of 28.18 cents per M c. f. was justified, whereas the contract price was but 26.5 cents.

In arriving at a Columbus gate price of 39.02 cents the majority commission below arrived at a river price of 22.04 cents per M c. f., which it proceeded to substitute for the contract price of 26½ cents. (R., 178.)

The minority commissioner, after eliminating the West Virginia commission's allowance for delay rentals and amortization, and after reducing the return allowed by the West Virginia commission, found a river price of 17.79 cents per M c. f. (R., 216.)

At R., 58, the court below said:

> "With reference to the item of depreciation and amortization, the West Virginia commission allowed 1.12 per cent. for depreciation and 4.15 per cent. for amortization. These figures were carried over into their findings by the majority commission. We hold elsewhere in this opinion that amortization cannot be allowed under Ohio law. The Ohio statute provides for an allowance for depreciation but not for amortization. Section 499-9, General Code. The commission has no discretion in adding items of valuation not specified by the Legislature.
>
> We therefore find that the river rate of 17.79 cents for gas delivered from West Virginia, fixed by the

minority of the commission, is not unreasonable, unlawful, nor confiscatory."

We contend that the foregoing holding by the court below is not consonant with comity or law and is clearly erroneous. Appellant will be unable to resist payment to The Ohio Fuel Gas Company and The Ohio Fuel Gas Company will be unable to resist payment to United Fuel Gas Company on such grounds.

The action of the court below results in reducing the annual revenue of United Fuel Gas Company from its sales to The Ohio Fuel Gas Company $1,348,849.58 below the price at which said United sells its gas to the Hope Natural Gas Company and other unrelated companies. (For this computation see page 89, Opening Brief, Case No. 608.)

While the difference between the river price of the majority commission—22.04 cents and of the minority commissioner—17.79 cents is 4.25 cents, yet on account of the fact that the West Virginia gas is mixed with Ohio gas when it reaches the Wheeler Compressor Station this difference is reduced to 1.2284 cents per M c. f. at the Columbus gates.

Had the court below approved the contract price of 26½ (R., 2915) cents then the minority's Columbus gate price would have become 34.22 cents and the 48 cent retail rate would have been increased to 50.60 cents.

In other words, recognizing the controlling significance of the contract for the West Virginia gas, it would take

2.60 cents more than the 48 cent rate to produce a 6½ per cent. return upon appellant's property without any regard to the omission of other cost items which should properly be considered in the gate price which appellant must pay to The Ohio Fuel Gas Company.

(The foregoing computations are explained at pages 89 to 92 of our Opening Brief in Case No. 608.)

ALLOCATION.

(Pages 150 to 204 of Opening Brief and 70 to 80 of Reply Brief, Case No. 608.)

Majority Court Opinion, R., 51, 59;

Majority Commission Opinion, R., 166;

Minority Commissioner's Opinion, R., 195;

The court below erred in testing the confiscatory nature of the rate by using the so-called "demand-mileage" method of allocating the transmission system valuation and expenses of The Ohio Fuel Gas Company.

There is no warrant in law for treating the transmission property and expenses on a different basis than applied to the production property scattered throughout the state, which latter property the court said should be allocated on a sales or M c. f. basis. (R., 51, 59.)

There is no warrant in law for dismembering a corporation which operates as a single unit or system simply because it sells a fraction of its product (11.1147%; R., 168) to a related company.

Common ownership of their capital stocks did not destroy the distinct corporate entities of either company.

Smith v. Illinois Bell Teleph, Co., 282 U. S., 133-141;

United Fuel Gas Co. v. R. R. Commission, 278 U. S., 300-320.

Neither the commission nor the city treated The Ohio Fuel Gas Company and appellant as a single enterprise. (cf. City Brief, Case 608, p. 20.)

Ohio law specifically permits the ownership of corporate stock by another corporation: (G. C., 8623-8. See Appendix.)

Appellant is the only company amenable to a valid exercise of the commission's authority. General Code, Sec. 614-2 (p. 284 of City's Brief in Case 608), defines a natural gas utility as one which sells to **consumers**. This has been the uniform construction of the statute by the courts, state and federal.

St. Clairsville v. P. U. C. O., 102 Ohio St., 574;
West Ohio Gas Co. v. P. U. C. O., 42 Fed. (2d), 899.

In the matter of allocation the commission treated the city in the identical manner which this court approved in the **Martinsville case (Wabash Valley Electric Co. v. Young**, 287 U. S., 448).

After ascertaining the valuation and expenses of The Ohio Fuel Gas Company, the commission allocated same according to sales, thereby arriving at a gate price. This gate price was added to the distribution cost found after

a valuation of appellant's distribution system and an allowance to appellant for expenses other than the cost of purchased gas.

The demand-mileage method of allocation which the court below without reason said should be applied to one part only of the property and expenses of The Ohio Fuel Gas Company (R., 51) is a theoretical yardstick based upon the location of a compressor station and not upon the location of a source of gas. Under this theory if the compressor station happened to be located at the Columbus gate then the city of Columbus would bear no part of the return on the valuation or of the expenses of the transmission system other than for a proportionate part of the particular compressor station.

While there are several pipe lines and routes for reaching the Columbus gates from both Homer and Wheeler Compressor Stations (R., 1801, 1802, 1805) the demand-mileage system assumed a single pipe line between Columbus and each of these stations. (R., 1935; 1960.) These two hypothetical lines were then apportioned according to the theoretical use made of them in furnishing gas to the Columbus gates and the fraction thus obtained was used as the allocation factor for the transmission valuation and expenses. Had either of the two compressor stations been any further away from Columbus (as well they might be), the allocation factor would have been larger, while if they had been nearer the allocation factor would have been smaller. The location of

a compressor station is a matter for managerial judgment.

No consideration was given to the distance that the gas traveled to reach the compressor station. For instance, in 1929 The Ohio Fuel Gas Company purchased approximately 29 per cent. of its gas supply from United Fuel Gas Company at Ravenswood, West Virginia (on the Ohio river). The Ohio Fuel transported this gas from Ravenswood to Wheeler Compressor Station, where it was mingled with Ohio gas and sent out over the entire system. (Co. Ex. 23, R., 3057.) Surely the transmission line between Ravenswood, West Virginia, and Wheeler Compressor Station is a part of The Ohio Fuel transmission system. Had the distance of this travel been used in obtaining the allocation factor it would have increased that factor from 10.2782 to 25.1395. In other words, had the actual use of the transmission system been considered, approximately two and one-half times as much transmission system value and expense would have been allocated to the Columbus gates. (R., 2068, 2069.)

A study of the record will convince any open mind that the commission trimmed valuation and expense allowances wherever possible, and at no place gave to the company any "break". Yet the entire commission, with a staff of trained engineers, found the demand-mileage method of allocation **impossible of application** to the transmission system of The Ohio Fuel Gas Company.

Allocation.

In respect of this system of allocation the majority commission said (R., 166):

> "Owing to the method of conducting the enterprise it is **absolutely impossible** to say that one pipe line or one well may be devoted to Columbus and that another pipe line or well may not be." (Boldface ours.)

The minority commissioner held against the demand-mileage allocation on account of (R., 195)

> "* * * the **impossibility** of determining a factor which would reflect justly the credit that should be given a particular community * * *." (Boldface ours.)

In the course of its opinion the majority commission said (R., 167):

> "As a matter of fact, gas is produced or purchased wherever available and transported in a system of interlocking pipe lines to the point of consumption and it may be broadly said that the entire system within the state of Ohio has, at some time and to some extent been devoted to the service of every municipality served by the company."

while the minority commissioner said (R., 195):

> "Columbus gas may come from West Virginia, it may come from southern Ohio fields or from northern Ohio fields. It may be brought through one of several transmission systems or compressed in one station or in many."

The court below seemed shocked that the valuation and expenses of The Ohio Fuel Gas Company should con-

tain a pipe line running to Toledo and another running to the Indiana state line. (R., 61.)

The court mentions one running to Cincinnati, but this is a mistake due to considering the claims of counsel for the city instead of the evidence. (See map, R. 3058 B.)

However, the court below overlooked entirely the fact that the revenues from these lines were credited to operating income. They entirely overlooked a single credit to operating expenses of $659,438.00 on account of "the differential charge to The Northwestern Ohio Natural Gas Company," which credit was made solely on account of deliveries of natural gas to Toledo. (R., 903.)

This single credit reduced the gate price at Columbus more than one cent per M c. f. (total sales 53,579,575 M c. f., R., 179), and more than off-sets the return on the entire valuation of the line to Toledo and the line to the Indiana border. Besides, as found by the commission (R., 167),

> "and it may be broadly said that the entire system within the state of Ohio has, at some time and to some extent, been devoted to the service of every municipality served by the company." (cf. Opinion Minority Commissioner, R., 195.)

As to the statement of the court below (R., 61):

> "By the preponderance of the evidence, the transmission lines north and northeast of Columbus do not contribute to the Columbus gas supply * * *."

this statement is contrary to the city's own evidence, without the slightest foundation in the record and con-

trary to the unanimous findings of the commission. (R., 166, 194.)

As in the case of the "line extending to Cincinnati"—which is not in this case, the court below must necessarily have found its "preponderance of the evidence" in the city's brief.

We say there is **no** such evidence, and refer to the city's own testimony and exhibits in substantiation of our claims.

As pointed out at page 191, et seq. of our opening brief in Case 608, more than one-half of the company's gas wells and operated leaseholds are located "north and northeast of Columbus."

At page 194, et seq. we show that 43½% of the horse power of the compressor stations is located north of Columbus. The reason for the greater proportion being in the south is accounted for by the light pressure wells in southeastern Ohio and the fact that all of the West Virginia gas first passes through Wheeler Station.

That we are not alone in our belief that the court below did not understand the subject of allocation may be seen from a reading of the opening article in the **Michigan Law Review for January, 1934**, and the notes thereto. (Quoted from at p. 203, Opening Brief Case 608.)

Wherever the demand-mileage system of allocation has been tried it has been abandoned. All of the cases are reviewed at page 158, et seq., of our opening brief in Case 608. In the same brief, at the pages indicated, we

have also called attention to the evidence in the record in respect of

(1) The mileage traveled by the gas. (p. 176.)

(2) The connections between compressor stations. (p. 178.)

(3) The operation of wells by classes and the necessity therefor. (p. 179.)

(4) The effect on purchased gas contracts. (p. 181.)

(5) How failure of gas supply for any community is overcome. (p. 182.)

(6) The unwise additional investment and added annual expense necessary to obtain data for making rates by demand-mileage allocation. (p. 183.)

(7) Direction of flow of gas. (p. 184.)

(8) Sources of gas. (p. 188.)

Location of the gas wells. (p. 191.)
Location of operated leaseholds. (p. 192.)
Location of the 38 compressor stations. (p. 194.)

A single illustration should suffice to show that such allocation cannot possibly be considered a local question, but one which produces a confiscation of property, and one which cannot be urged by appellant in accounting for the fair value of the gas purchased from The Ohio Fuel Gas Company, to wit:

In Company Exhibits 196 and 198 (originals) the demand mileage gate prices have been computed for the entire Ohio Fuel system. These run from less than 17¢ at Bay Village, in Cuyahoga county near Lake Erie,

about 150 miles "northeast of Columbus", to $1.37 at Portage, in Wood county, located about 125 miles northwest of Columbus. At Cygnet (also in Wood county) the rate is $1.09.

At Toledo, Ohio, further north than Portage and Cygnet, the rate is a little over 98¢. At Bowling Green, also in Wood county, the rate is 84¢. Bowling Green is about 10 miles north of Portage and 20 miles south of Toledo. At Upper Sandusky, a few miles from Bowling Green and closer to Toledo than to Columbus, the rate would be less than 28¢; while at Port Clinton, a few miles east of Toledo and Bowling Green, the rate is over 76¢. Upper Sandusky and Port Clinton are less than 50 miles apart. At Sandusky, Ohio, which is less than 10 miles from Port Clinton and about 40 miles from either Toledo or Bowling Green, the rate is a little over 28¢. At the Vandalia Station in Dayton, approximately 70 miles southwest of Columbus, the rate is a little over $1.00; while about 15 miles away at Troy the rate is 39¢; and 10 miles from Troy, at Piqua Measuring Station No. 2, the rate is 75¢.

Around the city of Columbus there are eight different measuring stations. The demand-mileage figures run from 20.19 cents to 41.29 cents. At each of these measuring stations, or points of delivery, the demand-mileage allocation produces a different gate price. Two of these stations, however, are located on the same line and the gas which comes to both of these stations must neces-

sarily come from the same compressor station. The point of delivery nearest the compressor station is the Linden Station, at which the rate is 41.29 cents (R., 3018A); while at the Cleveland Avenue Station, approximately two miles from the Linden Station and that much further away from the compressor station, the rate is 20.19 cents. In other words, gas traveling two miles further through the same pipe is worth less than one-half of the price at the Linden Station which it had passed.

When these inconsistencies were pointed out the city tried to account for them on a load factor explanation. However, in Company Exhibit 196 (original) we show that while the company load factor is 51.7%, the city of Columbus load factor is below the average, to-wit 49.7%.

Within a range of less than 50 miles the demand-mileage allocation will produce some rates which are nearly three times other rates in the same locality.

This brings us to what we want to center the court's attention on, to-wit: Assuming that 50 cents is the highest price which the Ohio Fuel may get for its gas, wholesale, at the city gates throughout the state to maintain its present volume of sales, that company will sustain an annual loss in revenue of $1,555,535 by reason of such a demand-mileage allocation. Yet this assumed maximum wholesale gate price for the state is only 2 cents above the price fixed for sales at retail in Columbus, which is situated in the middle of the state, whereas the gas ter-

ritory is located on the eastern side of the state extending from the Ohio river to Lake Erie.

Again, as shown by Company Exhibit 176 (original), The Ohio Fuel Gas Company is bound by many contracts and ordinances to deliver its gas at wholesale and to consumers at definite prices which cannot be changed for some years to come. The company has no means of passing on to other communities any reduction which Columbus might secure through the application of any such method of allocation as is proposed.

To attempt to tie communities to delivery of gas through given lines will destory the system which has been built up by The Ohio Fuel Gas Company. This will not only result in serious loss of revenues to the company, but in tremendous inconvenience and loss to the various communities which are thus deprived of an assurance of continuous supply from various sources.

We are not quarreling with the principle that the state has the right to fix utility rates according to any method or standard it chooses, so long as confiscation does not result. What we say here is that the record in this case shows beyond reasonable doubt that confiscation will necessarily result from the application of this method of allocation, even if the commission could find it possible of application.

As the demand-mileage allocation does not apply to any of the production system, the correction of the valuation for No. 1 leaseholds, the allowance of valuation on the reserve leaseholds, the allowance of delay rentals, the

correction of the valuation on gas well construction and equipment, the allowance for depletion would each and all be added to the 48 cent rate on the M c. f. or sales basis (R., 51). The effect in cents and fractions thereof on the retail rate for each of the foregoing items has been computed in our opening brief in Case 608 and is tabulated at p. 263, et seq. The method of computation will be found at the end of each of the respective subjects in our opening brief in Case 608.

At p. 232, et seq. of our opening brief in Case 608, we have shown that after the minority commissioner's valuation and operating expenses have been further reduced by reducing the leaseholds to the city's book cost of No. 1 acreage and by the application of the demand-mileage allocation, the rate is still confiscatory. The computations there made disregard the gate price contract (Co. Ex. 11, R., 2879) and proceed upon the same basis of calculation as followed by the commission.

ADDITIONAL SUBJECTS ARGUED IN BRIEFS IN CASE NO. 608.

Our argument on the following subjects has been stated as briefly as we can do so in our briefs in Case 608. We therefore ask the court to kindly refer to those briefs for:

	Opening Brief	Reply Brief
The contracts between related companies	238.	...

Additional Subjects Argued.

Appellant's gas supply contract	240; 263.	8.
Ohio Fuel's contract for West Virginia gas	245; 267.	...
Corporate development and relationship	7.	...
Treatment on account of intercorporate relations	11.	...
Due process	249.	7.
Rate of return	224; 270	38.
Valuation of Ohio Fuel's production and transmission property—		
Going concern value	123; 273.	65.
Work in progress	147; 275.	64.
Cost of organization	147; 276.	63.
Cost of financing	148; 276.	...
General overheads	148; 278.	97.
Working capital, materials and supplies	148; 279.	98.
Ohio Fuel Gas Company's operating expenses—		
Taxes	208; 266.	99.
Purchased gas	...	33
Valuation of appellant's distribution system—		
Gas holder	205; 281.	93.
Labor rates	205; 281.	...
Labor performance	205; 281.	81.
Going concern value	123; 206; 274.	65.

Working capital, materials and supplies	206; 280.	...
General overheads	206; 279.	97.
Cost of financing	206; 277.	...
Appellant's operating expenses other than gate price:		
Taxes	208; 266.	99.
Load building expense	218; 268.	101.
Collar leak clamp expense	219; 268.	102.

IRRELEVANT MATTERS IN CITY'S BRIEF.

The city in its brief in Case No. 608 has introduced five subjects which were not covered by any assignment of error and which were not argued in our opening brief in Case 608.

At pages 13 to 37 of our reply brief in Case No. 608 we have answered the city's argument on those subjects. Suffice it to here observe:

(a) That as to the fees of Columbia Engineering and Management Corporation: these were reduced to cost by the commission. (R., 169, 204.) No claim is made by appellant that more should be allowed.

(b) That as to The Preston Oil Company's oil profits: neither the commission nor the court below considered this a proper subject for consideration. Besides, the record does not show any oil profit to have been made in the year used as a yardstick in this case.

(c) That as to gasoline extraction profits: the com-

mission took an annual off-setting credit to operating expenses of The Ohio Fuel Gas Company of $76,363.00 (R., 203), which was much greater than the average gasoline extraction profit for the years about which the city introduced evidence.

(d) That as to The Federal Gas and Fuel Company, another smaller distributing company in the city of Columbus: the only imaginable reason for the city's statement in respect thereof was to have this court infer that said company was satisfied with the rate, when as a matter of fact it is enjoined by both the city and the commission from collecting a higher rate, and that case is being held pending the outcome of this case.

CONCLUSION.

The difference between the contract price (Co. Ex. 11, R., 2879) for the purchased gas and the gate price allowed in the 48 cent rate is 13.3 cents per M c.f.

As appellant purchases 5,955,221 M c. f. per year (R., 182, 220), this difference amounts to $791,944.00 per year, or for the five years' term of the ordinance $3,959,720.00, which is greater than the total present value fixed by the commission for all of appellant's property within the city of Columbus, exclusive of working capital and materials and supplies. (R., 183, 220.)

Appellant's concern, therefore, about the gate price should be readily understood.

If the gate price contract be disregarded we believe

that the gate price will be greater than 45 cents as will be apparent from the following tabulations:

At pages 240 to 245 of our opening brief in Case 608 we have shown existing facts which we believe will justify the 45 cents per M c. f. contract price for natural gas at the Columbus gates.

But discarding for the moment all of those tests, let us subject both the gate price as allowed below and the gate price fixed by the contract (45¢) to some other tests:

The gate price allowed below is.....	31.70¢
If we add to this the actual cost of lease rentals on the reserve acreage, it will increase the gate price.....	3.145¢
If the excise taxes, at the rate actually paid to the state of Ohio, be allowed, it will add to the gate price.....	.317¢
If the West Virginia gas which the Ohio Fuel buys is computed at the same rate at which the United sells to the Hope it will increase the gate price.....	2.645¢
If depletion is allowed, as it must be, on gas wells and operated leaseholds, it will increase the gate price.....	5.7129¢
If depreciation on the Ohio Fuel's property be computed at the rate conceded by the city, it will increase the gate price.....	2.0207¢
This will give a gate price of.....	45.5406¢

However, there is yet no allowance of any kind for amortization of facilities, no valuation of any kind for

reserve leaseholds, the gas wells are still depreciated upon the erroneous "rock pressure decline method" resulting in an insufficient allowance for annual depreciation, there is no allowance for work in progress, there is no allowance of any kind for going concern value, for cost of financing, and there is an insufficient allowance for working capital and general overheads.

To list just the cost of a few of the foregoing would add to the above gate price the amount set opposite each item (all on a 6½% return basis):

Lowest market value for No. 1 leaseholds	.5082¢
Lowest value of any kind in the record for leaseholds Nos. 2, 3 and 4	1.8520¢
Going concern value at 10% of the minority commissioner's valuation	.8592¢
Valuation of gas well construction and equipment, less observed depreciation	1.2601¢
Annual depreciation allowance on difference in gas well construction and equipment valuation	.4847¢
Work in progress	.0284¢
Amortization of facilities other than gas wells and leaseholds	3.8665¢
Difference between 6½% and 8% for rate of return	2.0303¢

For other items see table, page 263 opening brief, Case 608.

To make another test of the confiscatory nature of the 48 cent rate:

Conclusion.

Assume that the 31.70 cents gate price which produces the 48 cent Columbus rate is proper, then add to the 48 cent rate an allowance for any of the following: (page reference is to opening brief in Case No. 608).

The actual amount of excise taxes required by law to be paid on the 48¢ rate—this would increase the 48¢ rate by (pp. 208, 267)	.4895¢
Load building expenses (pp. 218; 268)	.5178¢
Collar leak clamp expense (pp. 219; 268)	.6698¢
An annual depreciation allowance at the rate conceded by the city of Columbus (pp. 221; 269)	.3614¢
A return at 7%—the increase is (p. 270)	.3551¢
A return at 7½%—the increase is (p. 270)	.7102¢
A return at 8%—the increase is (p. 270)	1.0652¢
Going concern value at the rate of 10% on the valuation fixed by the commission.	
At a 6½% return this adds to the 48¢ rate (pp. 129-131; 274)	.4501¢
At an 8% return this adds to the 48¢ rate (p. 274)	.5540¢
General overheads in the cost of reconstruction computed at the rate conceded by the city of Columbus.	
At 6½% it would increase the 48¢ rate (pp. 206; 279)	.0796¢
At 8% the foregoing would increase the 48¢ rate (p. 279)	.0980¢

Had appellant been allowed the customary 5% for working capital (pp. 206; 280).

At a 6½% return this would have increased the 48¢ rate ..... .1105¢

At 8% the foregoing figure would be..... .1360¢

If a return at 6½% had been allowed upon the gas holder, it would have increased the 48¢ rate (pp. 205; 281)..... .2163¢

At 8% the last mentioned figure would be (p. 281) ..... .2662¢

Had the labor rates and performances actually experienced by the company in the test year been used in computing the cost of reproduction new (pp. 205; 281).

At 6½% return it would have added to the 48¢ rate ..... .3181¢

At an 8% return it would have added..... .3915¢

It is therefore respectfully submitted that the law fixing the maximum price at which natural gas may be sold in the city of Columbus, Ohio, at 48¢ per M c. f. with a 75¢ per month minimum is repugnant to the Constitution of the United States for either or both of the following reasons, to-wit:

(a) Such law deprives appellant of its property without due process of law and denies to appellant the equal protection of the law contrary to Article Fourteen of the Articles in Addition to and Amendment of the Constitution of the United States.

(b) Such law unlawfully impairs the obligation of

the contract (Co. Ex. 11, R., 2879) between appellant and The Ohio Fuel Gas Company contrary to Section 10 of Article One of the Constitution of the United States.

The contractual latitude between inter-related companies was defined by this court in **United Fuel Gas Co. v. Railroad Commission**, 278 U. S., 300, wherein this court, by Mr. Justice Stone, said (p. 320):

> "We need not labor the point that a public service corporation may not make a rate confiscatory by reducing its net earnings through the device of a contract unduly favoring a subsidiary or a corporation owned by its own stockholders. Cf. Chicago & G. T. R. Co. v. Wellman, 143 U. S., 339, 345. We recognize that a public service commission, under the guise of establishing a fair rate, may not usurp the functions of the company's directors and in every case substitute its judgment for theirs as to the propriety of contracts entered into by the utility; and common ownership is not of itself sufficient ground for disregarding such intercorporate agreements when it appears that, although an affiliated corporation may be receiving the larger share of the profits, the regulated company is still receiving substantial benefits from the contract and probably could not have secured better terms elsewhere. Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Serv. Commission, 262 U. S., 276, 288; Houston v. Southwestern Teleph. Co., 259 U. S., 318."

In the case of **Missouri ex rel. Southwestern Bell Teleph. Co. v. Public Service Commission**, 262 U. S., 276, this court, by Mr. Justice McReynolds, said (p. 289):

> "It must never be forgotten that while the state may regulate, with a view to enforcing reasonable rates and charges, it is not the owner of the property

of public utility companies, and is not clothed with the general power of management incident to ownership."

See also:

Interstate Commerce Commission v. Chicago Great Western R. Co., 209 U. S., 108;
Chicago, M. & St. P. R. Co. v. Wisconsin, 238 U. S., 491;

Respectfully submitted,

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Columbus, Ohio, April 23, 1934.

APPENDIX.

General Code Section 8623-8. Corporate Capacity and Powers.

Every corporation of this state, heretofore or hereafter organized, shall have the capacity possessed by natural persons to perform all acts, within or without this state.

Subject to any limitations or restrictions which may be imposed thereon by the articles, every corporation shall have authority to

* * * * * * * * * * * * * *

Purchase, acquire, subscribe for, guarantee, hold and dispose of the shares, bonds and other evidences of indebtedness, or contracts, of any corporation, domestic or foreign;

* * * * * * * * * * * * * *